

Indiana Department of State Revenue

Revenue Ruling # 2006-03IT

July 24, 2006

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

Adjusted Gross Income Tax - Filing of Indiana Partnership Tax Return

Authority: IC 6-3-4-10; IC 6-3-2-2; 45 IAC 3.1-1-38 (1); 45 IAC 3.1-1-58, 59; 45 IAC 3.1-1-47; IC 6-3-4-12

Taxpayer requests the Department to rule whether the Liquidating LLC, a limited liability company formed pursuant to a Bankruptcy Court order for the sole purpose of liquidating remaining non-business assets of the taxpayer's companies and distributing proceeds to creditors of the taxpayer, is required to file an Indiana Partnership Tax Return (Form IT-65) pursuant to IC 6-3-4-10 and withhold tax on its allocable income pursuant to IC 6-3-4-12 as a result of the limited activities in Indiana of its manager.

STATEMENT OF FACTS

After some financial difficulties the taxpayer filed a petition with the court for relief under Chapter 11 of the bankruptcy code. Within six months of filing the petition, the taxpayer sold all of the businesses assets in various transactions mostly with the supervision and approval of the court. Shortly after the taxpayer had disposed of all its business assets it terminated all of its employees except for one or two who remained in order to supervise the final accounting, liquidation and dispersal of the businesses assets.

Following the bankruptcy proceedings the court confirmed the taxpayers "plan" on its procedure to liquidate remaining assets and distribute proceeds to its various creditors. In addition after an initial distribution the remaining assets of the taxpayer were transferred into a Liquidating Limited Liability Corporation ("LLC"). The LLC was chosen over a liquidating trust because it better facilitated the liquidation of the bankrupt company due to it being more widely recognized and because it is more "corporate in nature."

The LLC received no business assets in the way of inventory, real estate, machinery or other personal property. Furthermore the operating agreement was presented to the court and approved as part of the taxpayer's "plan" in order to liquidate the remaining assets of the company. Additionally under the guidelines of the court's approved "plan," every creditor of the

taxpayer having an “allowed claim” was automatically made a member of the LLLC. Furthermore, it makes no difference whether the creditor was secured or unsecured; no affirmative action was needed to become a member of the LLLC. However there is a difference in distribution for secured versus unsecured creditors.

In order to monitor the subsequent actions of the LLLC and as part of the court approved “plan” a liquidating committee was set up. The liquidating committee must approve all major decisions as part of the liquidation process before they are carried out. A liquidating agent was also appointed and approved by the court to act as the manager of the LLLC. The liquidating agent is in charge of the operating and claims reserves created under the plan as well as the liquidation process, any and all pending legal claims, filing tax returns and filing reports with the Bankruptcy Court. However, the liquidating agent was limited as to investment decisions to cash, money market funds or treasury bills, in order to protect the creditor’s interests.

The liquidating agent fulfilled his duties to the company as a full time employee for more than one year, and took a subsequent job with an unrelated corporate business in Indiana while still remaining the liquidating agent on a part time basis.

The LLLC’s “principle place of business” was originally determined by the court to be outside of Indiana and although the liquidating agent could petition the court to change the principle place of business he has yet to do so. Furthermore the official correspondences go to the P.O. Box located in the original “principle place of business,” even though the liquidating agent applied for a P.O. Box in Indiana to receive mail sent to the LLLC. Additionally other than certain LLLC records used by the liquidating agent in Indiana, no other property belonging to or associated with the LLLC is located within the state of Indiana. Finally, most individuals performing tasks for the LLLC are located outside the state.

For federal income tax purposes the LLLC is treated like a partnership. Furthermore, the taxpayer was deemed to have transferred its remaining assets either directly or indirectly to the holders of the “allowed claims” in satisfaction and discharge of such claims. Consequently the amount realized by the holder would equal the sum of any cash received from the immediate disbursement and the aggregate fair market value of the other property received by the holder pursuant to the plan in conjunction with the interest in the assets of the LLLC.

The value of the assets held by the LLLC were valued by the liquidating agent when transferred from the taxpayer to the LLLC on the effective date. The liquidating agent also valued the liabilities and expenses to be paid under the court approved plan. The Liquidating agent figured the aggregate tax basis of the LLLC’s assets as the total value of the assets transferred minus the liabilities and expenses. One initial problem that the LLLC faces is that it has collected significantly more in some cases than the initial estimate the liquidating agent made. The recovery by the LLLC generally is the only income that generates taxable gain as the amount recovered exceeds the original estimate of the potential recovery. The income made from the investments is generally significantly less than the amount of the expenses. Therefore all of the income of the LLLC relates to either the recovery of assets of the taxpayer for the benefit of its creditors under the court approved plan, or interest earned on funds held for distribution to the creditors.

DISCUSSION

IC 6-3-4-10 provides:

(a) Except as provided in subsection (b), every partnership doing business in this state, every partnership any partner of which is a resident, and every partnership which has gross income derived from sources within this state, shall make a return for each taxable year on a form to be prescribed by the department, which return shall correspond with the returns required by Section 6031 of the Internal Revenue Code, insofar as consistent with the provisions of this article. However, this section shall not be construed to render any partnership a taxpayer under this article.

(b) A partnership or a corporation that is exempt from income tax under Section 1363 of the Internal Revenue Code is not required to file:

(1) federal income tax Schedule K-1 (Form 1065) Partner's Share of Income, Credits, Deductions, Etc.; or

(2) federal income tax Schedule K-1 (Form 1120S) Shareholder's Share of Income, Credits, Deductions, Etc.;

with an annual return filed with the department. However, a federal income tax schedule described in this subsection must be available for inspection upon request by the department.

Therefore it is clear that the determinative factors of whether a partnership must file an Indiana Partnership Tax Return (Form IT-65) are one (1) if a partnership is doing business or has gross income derived from state sources and two (2) if the partnership has a partner who is a resident.

45 IAC 3.1-1-38 interpreting IC 6-3-2-2 states a taxpayer is “doing business” in Indiana if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state

The LLLC is not doing business in Indiana in the conventional sense (e.g. Manufacturing, agriculture, retail merchant, etc.) but rather it is conducting the business of liquidating the taxpayer’s remaining assets and distributing the proceeds to its various creditors. In performance of its duties the LLLC is also generating interest and capital gains income which is included in the meaning of “doing business.” Consequently the place of business, under this set of facts, is the home of the liquidating agent responsible for overall liquidating operations including investments.

Because the liquidating agent resides and administers his services to the LLLC within Indiana, the payroll factor becomes a concern. However, in order for the payroll factor to apply the LLLC’s income must be business income (45 IAC 3.1-1-47). Under 45 IAC 3.1-1-59, interest income is non-business income if the intangible with respect to which the interest was received did not arise out of or was not created in the regular course of the taxpayer’s trade or business operations or where the purpose for acquiring and holding the intangible was not related to or incidental to such trade or business operations, as the is case here.

Furthermore, IC 6-3-2-2 (g) through (j) provides in the instant case, the capital gains and loses and interest income (IC 6-3-1-21) are allocated to the commercial domicile of the LLLC as they are defined as non-business income.

In this case the commercial domicile is the LLLC's principle place of business. As stated above the principle place of business or commercial domicile is outside Indiana. Even though the liquidating agent is managing the liquidation process from Indiana, he would have to petition the court in order to move the principle place of business which he has not so chosen to do.

Therefore even though the liquidating agent is living in Indiana, the income generated is sourced to the commercial domicile of the LLLC, outside Indiana.

Additionally even if the LLLC was not "doing business" in Indiana, the LLLC has 123 partners who are residents of the state and is therefore required to file Form IT-65, whether it is actually "doing business" in Indiana or not.

As to the second issue of withholding, IC 6-3-4-12 states in pertinent part:

Every partnership shall, at the time that the partnership pays or credits amounts to any of its nonresident partners on account of their distributive shares of partnership income, for a taxable year of the partnership, deduct and retain therefrom the amount prescribed in the withholding instructions referred to in section 8 of this chapter.

However, because the LLLC has no Indiana source income the withholding requirement is not applicable in this case.

RULING

The LLLC is required to file an Indiana partnership return because it is "doing business" in Indiana and has partners that are Indiana residents. The LLLC, however, has no income sourced to Indiana and, therefore, is not required to withhold any amount from nonresident partners.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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